Internal Revenue Service

memorandum

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Br1:WEWilliams

date: FEB -7 1997

to: Assistant Commissioner (International) CP:IN
Attn: Chief, Collection Division
Francise Jones, Revenue Officer

from: Chief, Branch No. 1
Associate Chief Counsel (International) CC:INTL:1

subject [redacted]

This responds to your undated transmittal which we received on January 9, 1997. You requested our advice on the liability of a Canadian corporation for FUTA with respect to certain of its employees who perform services in the U.S.

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Issue

Whether a Canadian employer is liable for FUTA pursuant to a 1942 executive agreement between the U.S. and Canada with respect to employees who are Canadian citizens and who perform services within the U.S.?

Background

[redacted] (hereafter referred to as [redacted]) is a Canadian corporation. [redacted] sends employees who are Canadian citizens to work in the U.S. for periods of time not exceeding 60 months. [redacted] represents that the employees are complying with U.S. law, including the U.S.-Canada Income Tax Treaty, with respect to the filing of U.S. income tax returns and the payment of U.S. income tax. As to FICA taxes, [redacted] files Forms 941 reporting and paying social security taxes for those employees that the Canadian government has not certified as being covered by the Canadian social security system.

The question is whether [redacted] is liable for the tax imposed by I.R.C. § 3301 (FUTA) with respect to the wages paid to Canadian citizens who are performing services in the U.S. If FUTA applies to such wages, [redacted] is required to file Forms 940, Employer's Annual Federal Unemployment (FUTA) Tax Returns. It is [redacted] position that its employees who are Canadian citizens are subject to the Canadian unemployment tax and not to U.S. FUTA.

Discussion

I.R.C. § 3301 imposes an excise tax on every employer (as defined in section 3306(a)) with respect to wages (as defined in section 3306(b)) paid by him with respect to employment (as defined in section 3306(c)).

Section 3306(a) defines "employer", with respect to any calendar year, as any person who during any calendar quarter in the calendar year or the preceding calendar year paid wages of $1,500 or more; or, on each of 20 days during the calendar year or during the preceding calendar year, each day being in a different calendar week, employed at least one individual in employment for some portion of the day. Section 3306(b) defines "wages", with certain exceptions, as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

Section 3306(c) defines "employment" as including any service, of whatever nature, performed by an employee for the person employing him, irrespective of the citizenship or residence of either, within the U.S. Under the literal language of the Code, [redacted] is liable for FUTA with respect to wages paid to its employees performing services in the U.S.

[redacted] position is that a 1942 executive agreement between the U.S. and Canada, dated March 12, 1942 (E.A.S. 244; 56 Stat. 1451), exempts it totally from FUTA.

We gave you our views on the scope of the 1942 executive agreement in a memorandum dated July 26, 1996, a copy of which is attached. Our conclusion was that a Canadian employer is subject to FUTA with respect to an employee performing services in the U.S. under the following circumstances:

1. An employee all of whose services are performed in one U.S. state (i.e., localized in a "jurisdiction") (Arts. IV(a)(1) and (b)(i)).[1/] That is, if an employee of [redacted] performs services in a single U.S. state during an entire taxable period, [redacted] is subject to FUTA on the wages paid to its employee for such services.

2. An employee whose services are performed within and without a particular U.S. state, but the services performed without the U.S. state are incidental to the services performed within the U.S. state (Art. IV(a)(1) and (b)(ii)).

3. An employee, whose services are not localized in a "jurisdiction" (e.g., in a single U.S. state), but some of whose services are performed in a U.S. state, and his base of operations, or if he has no base of operations, the place from which his services are directed or controlled, is in that U.S. state (Art. IV(a)(2)(i)); or

4. An employee, whose services are not localized in a "jurisdiction", but some of whose services are performed in a U.S. state, and his base of operations or the place from which his services are directed or controlled is not in any jurisdiction in which some of his services are performed, but his residence is in such jurisdiction (i.e., a jurisdiction in which some of his services are performed) (Art. IV(a)(2)(ii)).

It is clear that application of the 1942 Agreement depends on the facts of each employee. [redacted] has provided you with some details concerning the time that [redacted] of its employees spent in the U.S. during various years from [redacted] through [redacted] For each employee, [redacted] has provided the number of weeks that the employee spent in specific U.S. states and the District of Columbia, as well as the number of weeks the employee was on travel, holiday/vacation, and break. [redacted] represents that it does not have a base of operations in the U.S. and that all of its employees performing services in the U.S. are residents of Canada. Therefore, it is [redacted] view that its employees' services are not "localized" in any U.S. state and, therefore, that tests #1 and #2 above do not apply.

[1/] The term "jurisdiction" is defined in Article I(a)(iv) of the Agreement to mean any U.S. state or Canada.

Further, [redacted] contends that since it does not have a location in the U.S. from which it directs the services of its employees (and apparently that the employees do not have a U.S. base of operations), and that none of the Canadian employees reside in the U.S., tests #3 and #4 above do not apply.

We will give you our view of the analysis that we think is required for each of [redacted] Canadian employees who perform services in the U.S. One example provided by [redacted] of the time that an employee spent in various U.S. states and on travel, holiday/vacation, and break is the following:

[redacted]

State	% of time in State	Weeks spent in State	Days spent in State[2]/
California	9%	4.68	33
Florida	7%	3.64	25
Illinois	1%	.52	4
Kentucky	2%	1.04	7
Louisiana	7%	3.64	25
Maryland	2%	1.04	7
N. Carolina	13%	6.76	47
Ohio	15%	7.80	55
Pennsylvania	4%	2.08	14
Texas	5%	2.60	16
Virginia	5%	2.60	16
Washington, D.C.	3%	1.56	10
Subtotals	73%	37.94	261
Travel	0%	1.56	10
Holiday/Vacation/ Break	24%	12.48	87
Totals[3]/	97%	51.98	359

With respect to [redacted] is subject to U.S. FUTA only if one of the following tests is satisfied:

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[2]/ [redacted] did not list the number of days. We have calculated days from the number of weeks spent in each State.

[3]/ Because of rounding, the totals are not exact.

1. An employee all of whose services are performed in one U.S. state (i.e., localized in a "jurisdiction") (Art. IV(a)(1) and (b)(1)).

This test is not satisfied, because [redacted] performed services during [redacted] in 11 states and the District of Columbia.

2. An employee whose services are performed within and without a particular U.S. state, but the services performed without the U.S. state are incidental to the services performed within the U.S. state (Art. IV(a)(1) and (b)(ii)).

[redacted] performed services in [redacted] U.S. states plus the District of Columbia. He spent more time performing services in Ohio than in any other state (15 percent of his time), followed by North Carolina in which he spent 13 percent of his time. Unless the services performed outside of Ohio, or alternatively outside of North Carolina (assuming one or the other of these states was his primary place of employment), were incidental to the services performed within the state of his primary employment, ATI was not liable for FUTA with respect to [redacted] services under Article IV(a)(1) and (b)(ii) of the 1942 Agreement.

3. An employee, whose services are not localized in a "jurisdiction" (e.g., in a single U.S. state), but some of whose services are performed in a U.S. state, and his base of operations, or if he has no base of operations, the place from which his services are directed or controlled, is in that U.S. state (Art. IV(a)(2)(i));

[redacted] performed services in 11 U.S. states plus the District of Columbia. According to [redacted] it maintains no base of operations in the U.S. Therefore, presumably any direction that [redacted] gives to [redacted] originates in Canada and not in a jurisdiction (i.e., a U.S. state) in which he performs services. Thus, unless [redacted] has a "base of operations" (e.g., an office, a specific location to which he returns between jobs to prepare reports and communicate with [redacted] etc.) in a U.S. state in which he performs services, [redacted] was not subject to FUTA tax under Article IV(a)(2)(i) of the 1942 Agreement.

4. An employee, whose services are not localized in a "jurisdiction", but some of whose services are performed in a U.S. state, and his base of

operations or the place from which his services are directed or controlled is not in any jurisdiction in which some of his services are performed, but his residence is in such jurisdiction (i.e., a jurisdiction in which some of his services are performed) (Art. IV(a)(2)(ii)).

According to [redacted] all of its employees who perform services in the U.S. are residents of Canada. However, under the substantial presence test in section 7701(b)(3), [redacted] who was present in the U.S. for 261 days in 1992, is considered a U.S. resident. As a U.S. resident, [redacted] is presumably a resident of a U.S. state. However, we leave investigation of the extent of [redacted] connection to any particular state for your consideration.[4]/ Unless there is a factual basis for concluding that an employee is a U.S. resident, within the meaning of I.R.C. § 7701(b); and a resident of a U.S. state in which he performs services for [redacted] it is doubtful that the IRS could sustain the position that [redacted] was liable for FUTA under Article IV(a)(2)(ii) of the 1942 Agreement.

Conclusions

It is our view that an analysis similar to the one above for [redacted] is required for each employee. Under the six examples forwarded to you by [redacted] no employee provided services in only one U.S. jurisdiction, and, thus, test #1 would not apply. To determine if [redacted] is liable for FUTA under test #2, you must determine whether an employee's services are focused primarily in one U.S. state and whether services outside of this state are incidental to the services performed in the primary state.

Tests #3 and #4 involve situations where services are not "localized", or primarily centered, in one jurisdiction (e.g., a U.S. state). To impose FUTA liability on [redacted] under test #3, an employee must either have a base of operations within, or [redacted] must direct the employee's activities from, a U.S. state in which the employee performs services. To impose FUTA liability on [redacted] under test #4, an employee must reside in a

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[4]/ You may wish to consider a line of cases involving the question of whether traveling salesmen may deduct living expenses under section 162. See, e.g., Hicks v. Commissioner, 47 T.C. 71 (1966), in which the Tax Court observed, at page 73, that "[i]n each of these cases it was found that the taxpayer literally carried his home on his back."

U.S. state in which he performs services for [redacted] These are all highly factual issues.

If you have any questions or if we can be of further assistance, please call Ed Williams at 874-4341 (or leave a voice mail message at 874-1319).

George M. Sellinger /EW
GEORGE M. SELLINGER

Attachment:
Copy of memo dtd. 7-26-96